Ontario Energy Board | Commission de l'énergie de l'Ontario

BY EMAIL

January 31, 2020

Ms. Christine E. Long
Registrar and Board Secretary
Ontario Energy Board
P.O. Box 2319
27th Floor
2300 Yonge Street
Toronto ON M4P 1E4

Dear Ms. Long:

Re: **Toronto Hydro-Electric System Limited (Toronto Hydro)**
Application for 2020-2024 Rates
OEB Staff Submission on Draft Rate Order
Board File Number: EB-2018-0165

In accordance with the Decision and Order, dated December 19, 2019, please find attached OEB staff's submission on the draft rate order in the above noted proceeding. Toronto Hydro and all intervenors have been copied on this filing.

Yours truly,

Original Signed By

Lawrie Gluck
Case Manager

cc: All parties in EB-2018-0165

ONTARIO ENERGY BOARD

OEB STAFF SUBMISSION ON DRAFT RATE ORDER

Toronto Hydro-Electric System Limited

2020 – 2024 Rates Application

EB-2018-0165

January 31, 2020

Introduction

Toronto Hydro-Electric System Limited (Toronto Hydro) filed a five-year Custom Incentive Rate-setting (Custom IR) application with the Ontario Energy Board (OEB) under section 78 of the *Ontario Energy Board Act*, *1998*, S.O. 1998, c. 15, (Schedule B) (OEB Act), seeking approval for changes to its distribution rates, to be effective January 1, 2020 to December 31, 2024 (the application).

The OEB issued its Decision and Order with respect to Toronto Hydro's application on December 19, 2019 (Decision). In the Decision, the OEB ordered Toronto Hydro to file a draft rate order reflecting the OEB's findings. On January 21, 2020, Toronto Hydro filed its draft rate order. On January 28, 2020, Toronto Hydro filed a minor update to the draft rate order.

OEB Staff Submission on Draft Rate Order

Subject to the comments on rate smoothing below, OEB staff submits that the draft rate order, with the expected updates to the revenue requirement calculation to reflect a late correction made to the Allowance for Funds Used During Construction (AFUDC) amount and the balances in certain deferral and variance accounts (DVA)[1], accurately reflects the findings set out in the Decision. OEB staff is concerned with the rate smoothing option provided by Toronto Hydro and believes that the OEB should order that either: (a) an unsmoothed option be implemented; or (b) certain changes to the rate smoothing option be made.

The Custom Price Cap Index (CPCI) funded revenue requirement based on the draft rate order is set out in the table below.[2]

[1] Cover Letter to Toronto Hydro Draft Rate Order / p. 1; and Cover Letter to Toronto Hydro Updated Draft Rate Order / p. 2.

[2] Derived from Toronto Hydro Updated Draft Rate Order / pp. 10-11. The CPCI funded revenue requirement will be impacted by the update to the capital-related revenue requirement amounts for the correction to the AFUDC amount. OEB staff notes that the calculation includes changes to the stretch factor and the inclusion of a capital stretch factor as ordered by the OEB. The calculation also includes a revised estimate for the inflation factor (increased from 1.2% to 2.0% based on the OEB's 2020 generic inflation factor). The inflation factor will be updated during each annual Custom IR application (2021-2024) and is subject to change.

DRO Revenue Requirement ($M)	2020	2021	2022	2023	2024	Total
CRR	$ 525.90	$ 563.20	$ 575.50	$ 627.50	$ 665.30	$ 2,957.40
Non-CRR	$ 224.40	$ 227.60	$ 230.80	$ 234.00	$ 237.30	$ 1,154.10
Base RR	$ 750.30	$ 790.80	$ 806.30	$ 861.50	$ 902.60	$ 4,111.50
I		0.0200	0.0200	0.0200	0.0200	
X		0.0060	0.0060	0.0060	0.0060	
Cn		0.0497	0.0156	0.0645	0.0438	
Scap		0.7122	0.7138	0.7284	0.7371	
Capital Stretch		0.0030	0.0030	0.0030	0.0030	
G		0.0020	0.0020	0.0020	0.0020	
CPCI		0.0453	0.0112	0.0597	0.0388	
CPCI Funded RR	$ 750.30	$ 784.31	$ 793.10	$ 840.48	$ 873.13	**$ 4,041.31**

The total CPCI funded revenue requirement reduction, as between the proposed amount and the draft rate order, is set out in the table below.[3]

($M)	2020	2021	2022	2023	2024	Total
Toronto Hydro Proposed CPCI Funded RR	$ 771.39	$809.03	$823.94	$874.60	$913.66	$4,192.61
DRO CPCI Funded RR	$ 750.30	$784.31	$793.10	$840.48	$873.13	$4,041.31
Reduction ($)	**$ (21.09)**	**$ (24.71)**	**$ (30.84)**	**$ (34.12)**	**$ (40.53)**	**$ (151.30)**
Reduction (%)	**-2.73%**	**-3.05%**	**-3.74%**	**-3.90%**	**-4.44%**	**-3.61%**

Based on the draft rate order, the CPCI funded revenue requirement for the 2020-2024 Custom IR term relative to the CPCI funded revenue requirement for 2015-2019 is an increase of $530.0 million (or 15.1%).[4] The 2020 base revenue requirement set out in the draft rate order reflects a $22.2 million (2.9%) decrease relative to the 2019 CPCI funded revenue requirement.[5]

OEB staff submits that Toronto Hydro's approach to implementing the rate base and capital expenditure changes ordered by the OEB is reasonable. These changes were converted to in-service addition reductions (as applicable) and capital-related revenue requirement reductions appropriately.[6] OEB staff also notes that Toronto Hydro

[3] The proposed CPCI funded revenue requirement reflects the updated amounts set out in Undertaking J1.8. This includes the updates discussed in the original filing of Undertaking J1.2 (July 2, 2019). However, there was a minor update to Undertaking J1.2 (July 31, 2019) for the application costs ($0.2 million) that are not reflected in these amounts. The draft rate order CPCI funded revenue requirement is derived from Toronto Hydro Updated Draft Rate Order / pp. 10-11. The CPCI funded revenue requirement resulting from the draft rate order will be impacted by the update to the capital-related revenue requirement amounts to reflect a correction to the AFUDC amount.
[4] Toronto Hydro Updated Draft Rate Order / pp. 10-11; and 1B-Staff-23 / p. 2.
[5] Toronto Hydro Updated Draft Rate Order / pp. 10-11; and 1B-Staff-23 / p. 2.
[6] The capital-related revenue requirement reductions include adjustments to the cost of capital (including a change to the return on equity (ROE) percentage to reflect the most recent OEB-approved ROE), depreciation expense, and PILs (including a recalculation of the PILs impact resulting from the Capital Cost Allowance (CCA) rule change).

confirmed that it excluded customer-specific energy storage system (ESS) investments from rate base as directed by the OEB.[7]

OEB staff also submits that the non-capital related revenue requirement (Operating, Maintenance & Administration costs and revenue offsets) changes directed by the OEB were properly implemented.

Further, OEB staff submits that Toronto Hydro's cost allocation has been properly updated to reflect the Decision. In addition, the revenue-to-cost ratio adjustment ordered by the OEB has been properly reflected in the draft rate order.

OEB staff also submits that all changes to Retail Transmission Service Rates (RTSRs), Retailer Service Charges, Regulatory Charges and Specific Service Charges necessary to reflect the most recent OEB approvals have been accurately reflected in the draft Tariff of Rates and Charges (Tariff).

OEB staff also accepts Toronto Hydro's proposal, as set out in the cover letter to the updated draft rate order, to update the balances in the Capital Related Revenue Requirement variance account (CRRRVA) and Derecognition account to reflect the best available information with respect to 2019 in-service additions.[8] In its reply submission, Toronto Hydro should confirm that it followed the OEB's order to "record the <u>entire</u> 2018 and forecasted 2019 revenue requirement impact of the CCA rule changes within the new sub-account of Account 1592 – PILs and Tax Variances – CCA changes" [emphasis added].[9]

OEB staff submits that the draft accounting orders for the new DVAs and the DVAs for which changes have been directed are accurate and should be approved by the OEB.

Finally, OEB staff submits that the foregone revenues for the period January 1, 2020 to February 29, 2020 have been calculated correctly by Toronto Hydro.

In the sections that follow, OEB staff will provide a brief discussion of the changes made by Toronto Hydro in the draft rate order to the renewable enabling improvement (REI) investment funding and the revenue offset amount. In addition, OEB staff will provide a detailed submission with respect to its concerns regarding the rate smoothing option provided by Toronto Hydro.

[7] Toronto Hydro Updated Draft Rate Order / p. 3.
[8] Cover Letter to Toronto Hydro Updated Draft Rate Order / p. 2.
[9] Decision and Order / pp. 149-150.

Renewable Enabling Improvement Investments

Toronto Hydro recalculated the REI-related revenue requirement in the draft rate order to reflect best available information and to rely on expected in-service dates (as opposed to capital expenditures).[10] The result is an approximate $4.6 million increase to the REI-related revenue requirement to be recovered through provincial funding (from $8.1 million in the updated evidence to $12.7 million in the draft rate order).[11]

OEB staff notes that for both of the REI programs eligible for provincial funding[12], the opening 2020 net fixed assets are unchanged.[13] However, the 2020 in-service additions for both programs have increased (along with some other minor changes to the in-service additions for the years 2021-2024). This results in higher REI-related rate base (and associated revenue requirement) for each year (2020-2024).[14] In fact, the total in-service additions of approximately $29.4 million over the 2020-2024 Custom IR term related to the REI programs that are eligible for provincial funding now exceed the approved 2020-2024 capital expenditure amounts ($18.6 million) for these programs[15] by $10.8 million.[16] OEB staff assumes the incremental in-service additions relative to the approved 2020-2024 capital expenditures for this program are associated with spending in years prior to 2020.

While OEB staff is unsure of the exact cause of the increase to the REI-related in-service additions, OEB staff is of the view that Toronto Hydro made the update in an attempt to address the OEB's findings to use the best available information and more precise estimates of in-service additions for the REI programs.[17] Therefore, OEB staff submits that the updated funding for the REI programs as set out in the draft rate order[18] is in accordance with the Decision. However, Toronto Hydro should provide further explanation regarding the change to REI-related in-service additions.

OEB staff notes that the difference between the approved provincial funding for the REI programs and the revenue requirement associated with the REI-related rate base on an

[10] Toronto Hydro Updated Draft Rate Order / p. 5.
[11] Toronto Hydro Updated Draft Rate Order / p. 5; and U-Staff-166.2 / Appendices A and B.
[12] Generation, Protection, Monitoring and Control (GPMC) and REI ESS.
[13] Toronto Hydro Updated Draft Rate Order / Schedule 6; and U-Staff-166.2 / Appendices A and B.
[14] Toronto Hydro Updated Draft Rate Order / Schedule 6; and U-Staff-166.2 / Appendices A and B.
[15] Decision and Order / p. 118.
[16] Toronto Hydro Updated Draft Rate Order / Schedule 6.
[17] Decision and Order / p. 118.
[18] Toronto Hydro Updated Draft Rate Order / Schedule 6.

actual basis is recorded in a variance account (Renewable Generation Connection Funding Adder Deferral Account - Sub-account Provincial Rate Protection Payment Variances (Account 1533)). As such, ratepayers are protected from any revenue requirement variance that may arise over the Custom IR term if the in-service addition forecast is, in the end, not accurate.

Other Revenue

OEB staff notes that Toronto Hydro recalculated the other revenue amount to include a $1 million increase to reflect gains on the sale of utility property and a small increase associated with updates to the Wireline Pole Attachment Rate and Retailer Service Charges as directed by the OEB. There is also an offsetting $0.3 million reduction to the other revenue amount to reflect a reduction to the revenues Toronto Hydro will receive through its street lighting contract.[19] The result of these changes is that the other revenue amount increased by approximately $0.7 million (from $47.1 million in the most up-to-date evidence to $47.8 million in the draft rate order).[20]

OEB staff was not expecting a reduction to the other revenue amount associated with the OEB's finding to use a monthly average approach in the calculation of rate base. However, OEB staff submits that the $0.3 million other revenue reduction associated with the street lighting contract is appropriate. OEB staff submits that the OEB's findings requiring the calculation of rate base using a monthly average approach resulted in a reduction to the rate base (and associated revenue requirement) for the street lighting assets.[21] Therefore, in the context that the street lighting contract[22] is designed to fully fund the revenue requirement for these assets, a reduction to the revenue requirement for these assets will also reduce other revenue.

Rate Smoothing

To address the OEB's direction to provide options for rate smoothing[23], Toronto Hydro proposed a phased approach to the disposition of Group 1 and Group 2 DVA balances, the Other Amounts[24] and the foregone revenue amount. Essentially, Toronto Hydro

[19] Toronto Hydro Updated Draft Rate Order / pp. 7-8.
[20] Toronto Hydro Updated Draft Rate Order / Schedule 11; and U-VECC-83.
[21] Toronto Hydro Updated Draft Rate Order / pp. 7-8.
[22] The revenues associated with the street lighting contract are classified as other revenue.
[23] Decision and Order / pp. 14, 173, 178.
[24] Other Amounts represent balances that have accumulated but for which Toronto Hydro did not previously request OEB approval to establish a DVA to capture these balances.

phased the start and end dates for the disposition of these balances over the Custom IR term to implement rate smoothing.[25]

OEB staff has two concerns with the rate smoothing option provided by Toronto Hydro:

1) Certain Group 2 DVA balances and Other Amounts are to be disposed starting in years later than 2020. OEB staff submits that, for these accounts with disposition start dates after March 1, 2020, the carrying charges have only been calculated to February 29, 2020.[26] Therefore, the interest for the period March 1, 2020 to the start date of disposition (which is as late as January 1, 2023 for some accounts) has not been reflected in the balance to be disposed. For all Group 2 DVA balances and Other Amounts that are to be disposed starting after March 1, 2020, the principal balances (and associated carrying charges) are credits to ratepayers. As such, ratepayers are being denied interest properly owed to them on credit balances being held by the utility.

2) The disposition of Group 2 DVA balances and Other Amounts (which include estimated amounts for 2019) in future years after the final audited balances will be known is not appropriate. In addition, the Decision requires Toronto Hydro to record the variances between the approved forecast 2019 Group 2 DVA balances and Other Amounts and the audited actual 2019 Group 2 DVA balances and Other Amounts in Account 1595 and dispose those variances in the 2021 Custom IR update application.[27] As such, for the accounts with disposition start dates after March 1, 2020, the true-up of the variances as between approved and audited actual will be disposed of to ratepayers prior to the underlying approved forecast balance. OEB staff submits that this is also not appropriate.

OEB staff submits that the simplest and most expeditious solution to its concerns is to begin disposition of the balances in all accounts on March 1, 2020.[28] OEB staff notes that although the OEB asked Toronto Hydro to provide a rate smoothing proposal, it did

[25] Toronto Hydro Updated Draft Rate Order / pp. 19-20.
[26] Toronto Hydro Updated Draft Rate Order / pp. 19-20.
[27] Decision and Order / p. 178.
[28] For the Group 1 DVAs, a 22-month disposition can be implemented starting March 1, 2020. For the Group 2 DVAs and Other Amounts, a 58-month disposition can be implemented starting March 1, 2020. Finally, for the foregone revenue amount, a 22-month disposition can be implemented starting March 1, 2020. Any required true-up between approved and actual balances can be recorded in Account 1595 and be addressed as part of Toronto Hydro's 2021 Custom IR update application.

not commit to implementing any rate smoothing proposal.[29] OEB staff also notes that rate smoothing is not strictly required in terms of the bill impacts. The total bill impact of the unsmoothed option for all rate classes, in all years of the Custom IR term, never exceeds the 10% threshold for rate mitigation[30] described in the Chapter 2 Filing Requirements.[31] In addition, OEB staff submits that there are many unknowns with respect to future total bill impacts due to the disposition of Group 1 DVAs, and potential changes to RTSRs and commodity charges. Therefore, the rate smoothing option provided by Toronto Hydro could actually exacerbate rate volatility in future years of the Custom IR term.

However, if the OEB determines that it would be appropriate to implement Toronto Hydro's phased approach to deferral account disposition to address year-over-year rate volatility, OEB staff submits that the following is the manner in which it should be implemented:

For the DVAs and Other Amounts with disposition start dates later than 2020, the balances to be disposed should be based on audited actuals (and calculated to include the appropriate amount of interest using OEB prescribed interest rates). These balances and associated rate rider calculations should be reviewed as part of the Custom IR update application in the relevant year (e.g. balances to be disposed starting January 1, 2023 would be reviewed as part of the 2023 Custom IR update application).

Alternatively, the following adjustments can be made if the OEB determines that it must approve the balances and associated rate riders for all DVAs and Other Amounts as part of the current proceeding. For the DVAs and Other Amounts with disposition start dates later than 2020, an estimate of the interest accrued to the start date of disposition should be included in the balance.[32] Any variance between the approved principal and interest amount and the actual amounts can be recorded in Account 1595 and be disposed of in the year in which the amount is to be disposed. For example, an account to be disposed starting January 1, 2023 should include estimated interest to December 31, 2022 and the variance between the approved principal and interest balance and the actual balance should be recorded in Account 1595 for disposition in 2023.

[29] Decision and Order / pp. 14, 173, 178.
[30] Toronto Hydro Updated Draft Rate Order / pp. 21-28.
[31] Chapter 2 Filing Requirements for Electricity Distribution Rate Applications / July 12, 2018 / p. 58.
[32] Toronto Hydro should use the most recently approved prescribed interest rate for DVAs to calculate this estimate.

OEB staff notes that Toronto Hydro has sought interim approval of its Tariff for the years 2021-2024.[33] Presumably, this request was made so that the OEB can approve the rate riders included in the Tariff for future years (as some are added and others are removed). The base distribution rates and some other charges included in the Tariff for 2021-2024 would be subject to change in the annual Custom IR update applications (as the inflation factor, the RTSRs and other generic charges would be updated). OEB staff submits that interim approval of the 2021-2024 Tariffs is only required if the OEB approves a form of rate smoothing that includes the approval of rate riders that start in future years. Otherwise, no approvals related to 2021-2024 Tariffs are required.

Finally, OEB staff requests that Toronto Hydro file a summary of bill impacts that shows the following:

- 2020-2024 annual impacts for sub-total A and total bill with and without rate riders included
- The 2020-2024 Custom IR term average impact for sub-total A and total bill with and without rate riders included

- All of which is respectfully submitted -

[33] Toronto Hydro Updated Draft Rate Order / p. 30.